Supreme Court, U.S.
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No. 01-508

In the Supreme Court of the United States

DAVID J. FELT, PETITIONER

v.

OFFICE OF THRIFT SUPERVISION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the Office of Thrift Supervision had standing to file and prosecute this adversary proceeding, which contests the dischargeability in bankruptcy of the monetary provisions of a judgment entered in OTS's favor as trustee for certain other injured persons.

2. Whether the terms of the district court's order granting judgment to OTS as trustee for certain other injured persons required OTS to assign its claims to those injured persons in 1991.

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals underlying the judgment appealed from (Pet. App. 1-16) is reported at 255 F.3d 220. The court of appeals' earlier opinion reversing the district court's grant of summary judgment on the issue of willfulness is unreported. The memoranda and orders that underlie the district court's amended final judgment (Pet. App. 20-35, 36-43, 49-72) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on June 21, 2001. The petition for a writ of certiorari was

filed on September 19, 2001. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In December 1983, petitioner purchased all of the stock of Bowie County Savings and Loan Association in New Boston, Texas, a federally insured thrift institution. Petitioner borrowed nearly $1.5 million from American Guaranty, Inc. (AGI), a firm that he owned, to complete the purchase. Petitioner renamed the institution Reliance Savings Association. Petitioner harmed Reliance when he engaged in self-dealing by indirectly selling two AGI loans to a Reliance subsidiary. On August 29, 1986, after the Federal Home Loan Bank Board (FHLBB) instituted an enforcement action against him, petitioner agreed with the FHLBB that he would sell his interest in Reliance within six months, and Reliance consented to the entry of a cease and desist order based on various regulatory violations. By that time, both Reliance and AGI were either insolvent or on the brink of insolvency. Pet. App. 2-3.

In September 1986, petitioner sent a letter to AGI noteholders offering them the opportunity to exchange their AGI notes for Reliance stock. The material accompanying the letter—which included a "preliminary offering circular"—used unaudited financial statements and misrepresented the appropriate accounting treatment of the exchange of AGI notes for Reliance stock. As a result, the material falsely stated that stockholders' equity in Reliance would be $4.5 million after the transaction, a figure that far exceeded Reliance's actual net worth of approximately $96,000. The letter and accompanying material also did not disclose that Reliance was subject to a cease and desist order, that petitioner was required to dispose of his stock

under the agreement with the FHLBB, and that another entity petitioner owned would be financing one-third of the Reliance stock purchases on favorable terms. Pet. App. 4-5.

In September 1986, petitioner attempted to get FHLBB approval for the "preliminary offering circular," but approval was refused because the financial data included in it were unaudited. On December 22, 1986, petitioner sent the potential investors in Reliance a revised circular, in which he stated that the offering was "not required to be approved by the FHLBB." Pet. App. 6. The revised circular continued to state that Reliance would have a positive capital balance of $4.5 million after the sale. On December 31, 1986, petitioner completed the transaction. Approximately 150 AGI investors exchanged their notes for about 60% of the Reliance stock. A second group of five investors paid cash, and the remaining eight investors purchased approximately one-third of the Reliance stock, with the special financing provided by the entity owned by petitioner. *Ibid.*

After the transaction was completed, FHLBB determined that the sale had not been made at arm's length, because much of the Reliance stock had been financed on special terms by petitioner's entity, the AGI noteholders had been coerced into swapping AGI notes for Reliance stock, and AGI itself was an affiliate of the seller to begin with. As a result FHLBB declined to permit Reliance to count the stock purchases as new equity. Reliance therefore had a negative net worth of $5.6 million, rather than the positive equity of $4.5 million projected in the offering circulars. Because of its negative net worth, FHLBB placed the thrift into receivership in 1988. Pet. App. 7.

In April 1988, the FHLBB commenced an action against petitioner seeking rescission of the sale of Reliance stock, because the sale had been made without FHLBB approval and through the use of an offering circular that contained material misstatements and omissions. The district court found petitioner liable, ruling that petitioner knew that the stock would be worthless immediately after the sale. On January 9, 1991, the district court entered a judgment in favor of the Office of Thrift Supervision (OTS) (the successor to the FHLBB) and against petitioner (the "Reliance judgment") in the amount of $4.2 million "in trust for individuals * * * who purchased Reliance Savings Association stock from [petitioner] during December, 1986." The judgment was affirmed on appeal. Pet. App. 7-8.

2. Before OTS was able to collect on the Reliance judgment, petitioner filed for bankruptcy in a case that ultimately was administered under Chapter 7 of the Bankruptcy Code (11 U.S.C. 701 *et seq.*). OTS filed a claim for $6.4 million, which covered the Reliance judgment plus costs and interest. OTS also alleged that the debt was non-dischargeable, because, *inter alia*, it resulted from petitioner's "defalcation while acting in a fiduciary capacity." 11 U.S.C. 523(a)(4). On March 31, 1997, the district court *sua sponte* ruled that petitioner's actions were "willful" as a matter of law, and that petitioner's conduct therefore constituted "defalcation" under Section 523(a)(4). At the same time the court rejected petitioner's arguments that OTS lacked standing. Pet. App. 9, 36-48.

Petitioner appealed, arguing that OTS lacked standing to contest dischargeability on behalf of the individual investors and that there were material issues of fact on the questions of whether petitioner was a fiduciary

for purposes of Section 523 of the Bankruptcy Code, and if so, whether he breached his fiduciary duties. Petitioner also argued that the district court erred in granting summary judgment *sua sponte* on the issue of whether petitioner acted willfully in breaching his fiduciary duties. The court of appeals "reversed in part, vacated in part, and remanded in part" as to the district court's *sua sponte* grant of summary judgment on the issue of willfulness. *In re Felt*, 176 F.3d 478 (5th Cir. 1999) (unpublished). On remand, OTS moved for summary judgment on the question of willfulness, and after full briefing, the district court granted OTS's motion and entered final judgment for OTS on June 29, 2000. Pet. App. 9-10, 49-77.

3. The Fifth Circuit affirmed. The court determined that the issue of "willfulness" on the prior appeal would have been relevant only if the court had decided that petitioner had breached a fiduciary duty and that OTS had standing to pursue the action. Those issues had been fully briefed to the court on the prior appeal. Accordingly, the court determined that its prior decision had necessarily resolved those questions adversely to petitioner, and "the law of the case doctrine precludes reconsideration of [petitioner's] fiduciary status, his breach of his fiduciary duties, or OTS's standing to pursue this action." Pet. App. 12. The court also affirmed the district court's determination that, based on undisputed evidence viewed in the light most favorable to petitioner, petitioner's actions were willful violations of his fiduciary duties and therefore constituted "defalcation" for purposes of Section 523(a)(4). *Id.* at 13-16.

ARGUMENT

The court of appeals' decision was correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore unwarranted.

1. The court of appeals correctly found that OTS had standing to contest the nondischargeability of petitioner's debt. Under 11 U.S.C. 523(c)(1), a debtor "shall be discharged * * * unless, on request of the creditor to whom such debt is owed, * * * the court determines such debt to be excepted from discharge." Accordingly, any "creditor to whom [the] debt is owed" may bring a claim of nondischargeability.

OTS has standing to contest the nondischargeability of the Reliance judgment because it is a "creditor to whom [the] debt is owed." A "creditor" is defined as an "entity that ha[d] a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. 101(10)(A).[1] A "claim" for purposes of the Bankruptcy Code is a "right to payment," which means "nothing more nor less than an enforceable obligation" 11 U.S.C. 101(5)(A); *Johnson* v. *Home State Bank*, 501 U.S. 78, 83 & n.4 (1991); *Pennsylvania Dep't of Pub. Welfare* v. *Davenport*, 495 U.S. 552, 559 (1990). The relevant portion of the January 9, 1991, Reliance judgment provided that "[t]he Office of Thrift Supervision, in trust for individuals * * * who purchased Reliance Savings Association stock from [petitioner] during December, 1986, shall recover from [petitioner]" the sum of $4,271,020, plus prejudgment interest, court costs, and postjudgment interest. Pet. App. 18. Thus, OTS has an enforceable right to receive

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[1] An "entity" is defined specifically to include a "governmental unit." 11 U.S.C. 101(15).

payment of that sum of money from petitioner, and OTS is therefore a "creditor to whom [the] debt is owed."[2]

2. Petitioner contends (Pet. 9-11) that the court of appeals' holding that OTS has standing to assert the nondischargeability of the Reliance judgment conflicts with the Eighth Circuit's decision in *Cannon* v. *Missouri*, 741 F.2d 1139 (1984). There is, however, no conflict. *Cannon* involved a suit by the State of Missouri to establish the nondischargeability of a restitution debt owing to eight individuals. The debt resulted from a successful civil suit brought by the Missouri Attorney General in state court against Cannon under the Missouri Merchandising Practices Act for alleged fraudulent misrepresentations as to the use of certain bond monies Cannon received. During the pendency of the civil action, Cannon commenced a Chapter 7 bankruptcy case. Thereafter, the state court entered an order holding that Cannon had violated the Act and enjoining any further violations. In addition, the state court ordered that Cannon make restitution to the eight individuals.

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[2] See also *Pennsylvania Dep't of Pub. Welfare*, 495 U.S. at 558-559 (Congress intended "debt" and "claim" to have coextensive meanings in Bankruptcy Code, connoting nothing more nor less than an enforceable obligation); *Fezler* v. *Davis (In re Davis)*, 194 F.3d 570, 573-577 (5th Cir. 1999); *FTC* v. *Austin (In re Austin)*, 138 B.R. 898 (Bankr. N.D. Ill. 1992) (FTC had standing to file claim and commence adversary proceeding to assert nondischargeability of debt arising from prior FTC order requiring debtor to set up consumer redress fund); *SEC* v. *Cross (In re Cross)*, 218 B.R. 76 (B.A.P. 9th Cir. 1998) (SEC had standing to prosecute nondischargeability action involving judgment requiring debtor to make restitution to investors); *SEC* v. *Hodge (In re Hodge)*, 216 B.R. 932 (Bankr. S.D. Ohio 1998); *SEC* v. *Kane (In re Kane)*, 212 B.R. 697, 700 (Bankr. D. Mass. 1997); *SEC* v. *Maio (In re Maio)*, 176 B.R. 170 (Bankr. S.D. Ind. 1994).

Unlike petitioner, Cannon owed no debt to the government that was seeking a declaration of nondischargeability. As the Eighth Circuit explained, the state court judgment "specifically ordered that restitution payments be made to eight enumerated individuals" and, as a matter of state law, "the Attorney General may not sue on behalf of private individuals in a private action." 741 F.2d at 1141 (citing *State ex rel. Barker* v. *Chicago & A.R.R.*, 178 S.W. 129 (Mo. 1915) (en banc)). For those reasons—which were all matters of Missouri law—the Eighth Circuit held that the State of Missouri could not pursue the claim of nondischargeability in *Cannon*. See 741 F.2d at 1142. By contrast, the Reliance judgment in this case specifically provided that OTS "shall recover" the funds at issue from petitioner, Pet. App. 18, and there is no statutory or other bar to the OTS's prosecution of an action of this sort. Accordingly, the decision of the Eighth Circuit in *Cannon* does not conflict with the Fifth Circuit's decision in this case.

3. Petitioner argues (Pet. 9-11) that the fact that OTS was not the only party authorized to enforce the Reliance judgment limits its ability to bring a nondischargeability claim. Petitioner relies on *Nathanson* v. *NLRB*, 344 U.S. 25, 27 (1952), in which this Court held that the NLRB is a creditor with respect to certain back pay awards under the National Labor Relations Act for purposes of bringing a nondischargeability claim under the Bankruptcy Act. In reaching that conclusion, the Court noted that "Congress has made the [NLRB] the only party entitled to enforce the [National Labor Relations Act]." *Ibid.* But that factor was not the basis of the Court's decision. The Court's decision in *Nathanson* instead turned on the definition of "creditor" under the Bankruptcy Act, see *id.* at 27 n.1

(citing definition), and the fact that, as the Court explained, "[a] back pay order is a command to pay an amount owed the Board as agent for the injured employees." *Id.* at 27. As the Fifth Circuit explained in *Fezler* v. *Davis (In re Davis)*, 194 F.3d 570, 576-577 (1999), numerous courts have agreed since *Nathanson* that "an entity with statutory authority to prosecute and collect a claim against the debtor, even if other persons are entitled to ultimate payment on the claim, is a creditor in its own right, absent a statutory provision to the contrary." See *ibid.* (citing cases). That principle governs this case as well.

4. Petitioner also contends (Pet. 7) that further review is warranted to address the question "whether a federal regulatory agency has standing to collect a debt owed to third parties where the judgment states the regulatory agency shall assign their interest to the third parties." As explained above, the debt in this case was owed to OTS, albeit as a trustee for third parties. Petitioner cites no other case addressing the situation in which a federal agency seeking to obtain a declaration of nondischargeability has been ordered by a court to assign its debt to third parties for whom it is acting as trustee. Further review of any fact-bound questions presented by that situation is accordingly unwarranted.

In any event, petitioner rests his argument on the contention that OTS was required to assign its interests to third parties by September 1, 1991, and that OTS's failure to do so by that date should preclude it from pursuing its nondischargeability claim in this case. The district court did not, however, require that OTS assign its claims by any particular date. The Reliance judgment provided that OTS was to send a copy of the judgment "to each person who purchased Reliance Savings Association stock" from petitioner, that "[e]ach

stockholder has until September 1, 1991, to file a claim" with OTS for its share of the damages, and that OTS "shall make a pro rata assignment of its interest in the judgment to all the stockholders who file a claim by September 1, 1991." Pet. App. 18-19. Thus, although the district court required the stockholders to file their claims with OTS prior to September 1, 1991, the court did not set any deadline for OTS to assign its interests to the stockholders. Petitioner offers no reason why the district court's decision should be construed to have set such a deadline for OTS. Moreover, if there were a valid claim that OTS had violated an obligation under the terms of the judgment, this bankruptcy action would not have been the appropriate forum to litigate that claim.

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

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